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SUBJECT: KAZAKHSTAN: SCENESETTER FOR SPECIAL ENVOY MORNINGSTAR

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ASTANA 00001407 001.2 OF 005

11. (U) Sensitive but unclassified. Not for public Internet.

12. (SBU) SUMMARY: Embassy Astana warmly welcomes your August 26-28 visit to Kazakhstan, which comes at a particularly opportune time. With its upcoming 2010 chairmanship of the Organization for Security and Cooperation in Europe (OSCE) and its thriving energy sector, Kazakhstan is showing increasing confidence on the international stage. Kazakhstan has proven to be an increasingly reliable security partner and a steady influence in a potentially turbulent region. The pace of democratic reform, however, has been slow, with political institutions, civil society, and the independent media still underdeveloped. Our fundamental strategic objective is a secure, democratic, and prosperous Kazakhstan that embraces market competition and the rule of law; continues its partnership with us on the global threats of terrorism, weapons of mass destruction (WMD) proliferation, and narco-trafficking; and develops its energy resources in a manner that bolsters global energy security.

13. (SUMMARY, CONTINUED) Since your last visit to Astana on July 10, negotiations over the Kazakhstan Caspian Transportation System (KCTS) have stalled, KazMunaiGas (KMG) postponed the sale of MangistauMunaiGas to the China National Petroleum Corporation (CNPC), and the Antimonopoly Agency has pushed to raise the export customs duty on oil, gasoline, and diesel fuel. Despite these developments, Kazakhstan continues to offer attractive investment opportunities, particularly for oil exploration and production. Your visit can help get the KCTS negotiations back on track and shed light on the government's plans and priorities regarding future

energy transactions and transportation options. END SUMMARY.

ECONOMY: AGGRESSIVE STEPS TO TACKLE ECONOMIC CRISIS

14. (SBU) Kazakhstan is Central Asia's economic powerhouse, with a GDP larger than that of the region's other four countries combined. Economic growth averaged over nine percent per year during 2005-07, before dropping to three percent in 2008 with the onset of the global financial crisis. The International Monetary Fund is predicting negative two percent growth for Kazakhstan in 2009, with an economic recovery poised to begin in 2010. Astute macroeconomic policies and extensive economic reforms have played an important role in Kazakhstan's post-independence economic success. The country is justifiably proud of its modern banking and financial system, a well-endowed pension fund, and a sovereign wealth fund with over \$20 billion in assets. The government has taken significant steps to tackle the domestic reverberations of the economic crisis, allocating around \$20 billion to take equity stakes in private banks, prop up the construction and real estate sectors, and support small- and medium-sized enterprises and agriculture.

15. (SBU) On a less promising note, the Kazakhstanis announced in June that they would suspend their bilateral negotiations to accede to the World Trade Organization (WTO) and would instead launch negotiations together with Russia and Belarus to enter the WTO jointly as a customs union. We have informed Kazakhstan that there is no mechanism allowing a customs union to accede to the WTO without its member states doing so individually.

16. (SBU) The banking sector continues to struggle, as Kazakhstan's leading commercial banks have been unable to repay creditors and seek to restructure their debt. On July 24, BTA Bank, the country's largest commercial bank in terms of deposits, declared a moratorium on interest payments, which follows the bank's decision in April to cease debt principal payments. BTA's external debts are valued at \$13 billion, of which the bank said it will repay \$3 billion this

ASTANA 00001407 002.2 OF 005

year. In 2008, BTA's net losses were \$7.88 billion, and total obligations exceeded the value of its assets by \$4.9 billion. Kazakhstani authorities continue to investigate former BTA Chairman Mukhtar Ablyazov and other former top managers of the bank. On July 14, the Prosecutor General's office charged 12 members of BTA's credit committee with embezzlement, and six were found guilty and sentenced to jail.

AN EMERGING ENERGY POWER

17. (SBU) Kazakhstan produced 70.7 million tons of oil in 2008 (approximately 1.41 million barrels per day, or bpd), and is expected to become one of the world's top ten crude exporters soon after 2015. From January - July, Kazakhstan increased production of oil and gas condensate by six percent, to 43.6 million tons, compared to the same period last year. U.S. companies -- ExxonMobil, Chevron, and ConocoPhillips -- have significant ownership stakes in each of Kazakhstan's three major hydrocarbon projects: Tengiz, Kashagan, and Karachaganak.

18. (SBU) While Kazakhstan has significant gas reserves (2.0 trillion cubic meters is a low-end estimate), current gas exports are less than 10 billion cubic meters (bcm), in part because gas is being reinjected to maximize crude output, and in part because Gazprom, which has a monopoly on the gas market in the region, pays producers only a fraction of the going European price. The country's 40 bcm gas pipeline to China will help to break that monopoly, although the majority of the gas that will be exported via this pipeline will come from Turkmenistan and Uzbekistan, not Kazakhstan. The first line of the China gas pipeline was completed in July, and the first shipments are planned in November. Kazakhstani gas exports to China will be modest, 4-6 bcm annually. The government of Kazakhstan has made several public statements confirming that it has no objection to the Nabucco gas pipeline project, but the government has emphasized that Kazakhstan does not and will not produce enough gas to supply the pipeline.

19. (SBU) In the next five years, Kazakhstan's largest oil and gas

fields are poised to increase production dramatically:

-- Tengizchevroil, with 50 percent Chevron and 25 percent ExxonMobil ownership, increased output this year to 600,000 bpd, and its Future Growth Project will increase production to more than one million bpd.

-- Kashagan -- the largest oilfield discovery since Alaska's North Slope, and among the world's most technically complex oil development projects -- is expected to come on-line around 2014, with production reaching one million bpd by 2020.

-- The Karachaganak Petroleum Operating Company, in which Chevron owns 20 percent, contains more than 1.2 billion tons of oil and condensate, and 1.35 trillion cubic meters of gas. This year, the consortium is expected to approve Phase III, which would increase oil production to 350,000 bpd, and gas to 38 bcm/year.

-- On June 12, ConocoPhillips signed a contract to explore and develop the offshore N Block, estimated to contain 2.13 billion recoverable barrels of oil.

-- China's CNPC owns and operates AktobeMunaiGas (130,000 bpd) and PetroKazakhstan (220,000 bpd), and once it completes the acquisition of 50 percent of MangistauMunaiGas (150,000 bpd), it will control approximately 20 percent of Kazakhstan's total oil production in 2009.

-- Russia's Rosneft continues to explore the offshore Kurmangazy field, where two appraisal wells have been unsuccessful.

-- Other significant, but undeveloped, oil and gas reservoirs in the North Caspian include Pearls (lead operator Royal Dutch Shell),

ASTANA 00001407 003.2 OF 005

Satpayev (negotiations ongoing with India's Oil and Natural Gas Corporation), Zhambyl (negotiations ongoing with the Korean national oil company), and Abai (negotiations ongoing with Norway's Statoil).

10. (SBU) With these significant oil production increases on the horizon, Kazakhstan must develop additional transport routes to bring its crude to market. Our policy is to encourage Kazakhstan to seek diverse transport routes, which will ensure the country's independence from transport monopolists. Currently, most of Kazakhstan's crude is exported via Russia, although some exports flow east to China, west across the Caspian through Azerbaijan, and south across the Caspian to Iran. In July, for example, KMG announced the completion of the Atasu-Alashankou segment of the 3,000 kilometer oil pipeline to China, which will initially carry 200,000 bpd, with expansion capacity of 400,000 bpd.

11. (SBU) We support the expansion of the Caspian Pipeline Consortium (CPC) pipeline, which is the only oil pipeline crossing Russian territory that is not entirely owned and controlled by the Russian government. We also support implementation of KCTS, which envisions a "virtual pipeline" of tankers transporting up to one million barrels of crude per day from Kazakhstan's Caspian coast to Baku, from where it will flow onward to market through Georgia, including through the Baku-Tbilisi-Ceyhan (BTC) pipeline. Negotiations with international oil companies to build the onshore pipeline and offshore marine infrastructure for this \$3 billion project have recently stalled, although the government has expressed an interest in resuming talks. The U.S. Trade and Development Agency is considering providing technical assistance to expedite clearance of vessels at port, and ensure that Kazakhstan's maritime laws and regulations meet international standards. While a trans-Caspian crude pipeline would likely be a cheaper long-term transport option, Kazakhstan is reluctant to openly pursue such a pipeline in the absence of an agreement on delimitation of the Caspian Sea among the five Caspian littoral states.

DEMOCRACY: SLOW GOING

12. (SBU) While the Kazakhstani government articulates a strategic vision of democracy, it has lagged on the implementation front.

President Nazarbayev's Nur Otan party officially received 88 percent of the vote and won all the parliamentary seats in August 2007 elections which OSCE observers concluded did not meet OSCE standards. The next parliamentary and presidential elections are scheduled for 2012.

¶13. (SBU) When Kazakhstan was selected to be 2010 OSCE chairman-in-office at the November 2007 Madrid OSCE Ministerial meeting, Foreign Minister Tazhin promised his government would amend Kazakhstan's election, political party, and media laws in accordance the recommendations of the OSCE and its Office of Democratic Institutions and Human Rights (ODIHR). (NOTE: Foreign Minister Tazhin also promised that as OSCE chairman, Kazakhstan would support the OSCE's Human Dimension and preserve ODIHR's mandate, including its critical role in election observation. END NOTE.) President Nazarbayev signed the amendments into law in February. While key civil society leaders were disappointed that the new legislation did not go further, we considered it to be a step in the right direction and continue to urge the government to follow through with additional reforms.

¶14. (SBU) On August 8, in a closed session, Taraz city court found the editor and owner of "Alma-Ata Info," Ramazan Yesergepov, guilty of divulging classified documents and sentenced him to three years in prison. Yesergepov's wife announced his intention to appeal the verdict, but no date for the appeal has been set. Local and international civil society representatives and opposition activists have sharply criticized the ruling. Local and international print media picked up the critical statements made by Reporters Without Borders, Freedom House, and the OSCE's Representative on Freedom of

ASTANA 00001407 004.2 OF 005

the Media. We believe that the sentence against Yesergepov is incongruent with Kazakhstan's OSCE commitments on media freedom. The Ambassador has publicly urged the Kazakhstani authorities to apply international norms in resolving such issues, and has raised the Yesergepov case privately with senior government officials.

¶15. (SBU) While the Kazakhstanis pride themselves on their religious tolerance, religious groups not traditional to Kazakhstan, such as evangelical Protestants, Jehovah's Witnesses, Hare Krishnas, and Scientologists, have faced difficulties with the authorities. Parliament passed legislation in late 2008 aimed at asserting more government control over these "non-traditional" religious groups. Following concerns raised by civil society and the international community, President Nazarbayev chose not to sign the legislation, but instead sent it for review to the Constitutional Council -- which ultimately declared it to be unconstitutional.

¶16. (SBU) Though Kazakhstan's diverse print media include many newspapers sharply critical of the government and of President Nazarbayev personally, the broadcast media are essentially government-controlled. On July 10, President Nazarbayev signed into law Internet legislation which will provide a legal basis for the government to shut down and block websites whose content allegedly violates the country's laws. This appears to be a step in the wrong direction at a time when the Kazakhstan's record on democracy and human rights is in the spotlight because of its forthcoming OSCE chairmanship. We have expressed our disappointment that the legislation was enacted, and have urged the government to implement it in a manner consistent with Kazakhstan's OSCE commitments on freedom of speech and freedom of the press.

AFGHANISTAN: POISED TO DO EVEN MORE

¶17. (SBU) Kazakhstan has provided significant support to our stabilization and reconstruction efforts in Afghanistan, and in recent months, has expressed a willingness to do even more. We signed a bilateral blanket over-flight agreement with Kazakhstan in 2001 that allows U.S. military aircraft supporting Operation Enduring Freedom (OEF) to transit Kazakhstani airspace cost-free. This was followed in 2002 with a bilateral divert agreement that permits our military aircraft to make emergency landings in Kazakhstan when aircraft emergencies or weather conditions do not permit landing at Kyrgyzstan's Manas Air Base. There have been over 6500 over-flights

and over 60 diverts since these agreements went into effect. In January, Kazakhstan agreed to participate in the Northern Distribution Network -- which entails commercial shipment through Kazakhstani territory of non-lethal supplies for U.S. troops in Afghanistan. Kazakhstan is working on sending several staff officers to the International Security Assistance Forces (ISAF) headquarters in Kabul and is considering providing small-scale non-combat military support, as it did for five-plus years in Iraq.

¶18. (SBU) The Kazakhstani government provided approximately \$3 million in assistance to Afghanistan during 2008 for food and seed aid and to construct a hospital, school, and road. The Kazakhstanis are finalizing a proposal to provide free university education in Kazakhstan to Afghan students. The government has also offered to provide training to Afghan law enforcement officers at law enforcement training institutes in Kazakhstan, and is working on a 2009-2011 assistance program for Afghanistan that might include free university education for up to 1,000 Afghan students. The Kazakhstanis hope to make Afghanistan one of their priority issues during their 2010 OSCE chairmanship.

NON-PROLIFERATION: A HALLMARK OF BILATERAL COOPERATION

¶19. (SBU) Non-proliferation cooperation has been a hallmark of our bilateral relationship since Kazakhstan quickly agreed to give up the nuclear weapons it inherited from the USSR after becoming independent. The Kazakhstanis recently ratified a seven-year

ASTANA 00001407 005.2 OF 005

extension to the umbrella agreement for our bilateral Cooperative Threat Reduction (CTR) program, which remains the dominant component of our assistance to Kazakhstan. Key ongoing CTR program activities include our efforts to secure the radiological material at the Soviet-era Semipalatinsk nuclear test site and to provide long-term storage for the spent fuel (sufficient to fabricate 775 nuclear weapons) from Kazakhstan's BN-350 plutonium breeder reactor.

¶20. (SBU) The Kazakhstanis are active participants in the Global Initiative to Combat Nuclear Terrorism and are seeking additional ways to burnish their non-proliferation credentials. On April 6, President Nazarbayev announced publicly that Kazakhstan is interested in hosting the Nuclear Threat Initiative's IAEA-administered international nuclear fuel bank. We welcomed the offer, but explained to the Kazakhstanis that they need to work out the details directly with the IAEA. President Nazarbayev also has called for the United Nations to designate August 29 as annual World Non-Proliferation Day, which we support.

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